

# INFORMATION REQUIREMENTS FOR INTERNAL SERVICE RATE SETTING

Prepared for the  
**Legislative Finance Committee**

by

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December 6, 2001

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# INTRODUCTION

Montana law specifies the structure of funds in the state treasury. Proprietary funds are one of the categories of funds listed and are used to account for activities similar to those often found in profit-seeking businesses of the private sector. A government entity does not seek to earn a profit, but only seeks to recover costs incurred from the activity.

Proprietary funds are divided into two types: 1) enterprise; and 2) internal service. The primary distinction between these two types of proprietary funds is who pays the fees for the activities of fund. Enterprise funds are used when the activities are provided to the public for a fee. Internal service funds are used when the activities are provided to another government entity on a cost reimbursement basis.

The 1995 legislature changed statute to move proprietary funds off budget<sup>1</sup>. This change removed the requirement for programs providing activities funded with internal service funds to have appropriations approved by the legislature. This requirement was replaced with the constraints that:

?? The fees and charges that finance internal service funds must be commensurate with costs

?? The fees and charges must be approved by the legislature in the General Appropriations Act

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<sup>1</sup> HB 576, Chapter 556 of Montana Session Laws 1995 (Section 4) changed 17-8-101, MCA, by removing the requirement to have an appropriation made by law in order for funds to be paid out of the treasury for the enterprise and internal service fund types. The requirement for an appropriation was replaced with other requirements: 1) fees and charges for services deposited in the internal service fund type must be based upon commensurate costs; and 2) the maximum internal service fund type fees and charges for a biennium must be approved by the legislature in the general appropriations act.

Prior to this change, these programs were appropriated and their funding budgeted. Likewise, the customers of the programs were budgeted for their payments to the programs. This resulted in a doubling of a portion of the state budget, since budgets were recorded for both the expenditures for the customer payments to the program and for the program's expenses to provide the service. The primary intent of HB 576 was to eliminate this double counting of budgets for essentially the same expenditures. The legislature didn't intend to relinquish control of the level of state expenditures previously controlled with appropriations, but intended to control the level of internal service fund expenses by tying costs to fees and controlling the level of the fees.

Statute specifically states that the legislature must approve rates charged by an internal service type proprietary fund. However, it does not direct the legislature to approve rates charged by an enterprise type proprietary fund. As such the legislature has provided only a cursory review of enterprise funds to identify any public policy issues and unjustified abnormalities of their fund equities. Because there is no specific direction for the legislature to take action for enterprise funds, no changes are recommended to their information requirements or review and presentation processes. Only internal service funds will be discussed in this report.

- ?? The fees and charges approved by the legislature are the maximum that can be charged for the biennium

The 2001 legislature raised concerns that the information presented to it was not sufficient to adequately review and approve rates, and to set funding policies for internal service funds. This report documents a review of the process for developing and requesting internal service rates. It then provides recommendations for Legislative Finance Committee (LFC) concurrence to improve the process and better allow the legislature to impact fiscal policies while approving internal service rates. Recommendations are separated into two broad types:

- ?? Recommendations to improve how information is gathered and presented
- ?? Recommendations to improve the decision process

## **WHAT DOES ALL THIS MEAN AND WHY DO IT?**

The legislature is the branch of state government that sets public policy and appropriates funds for disbursement from the state treasury. As such, it's essential that the legislature get the information in the form it needs to make informed decisions. In order for the legislature to effectively set public policy for internal service funded activities, it must base its decisions on consistent, complete, and accurate information that portrays all aspects of the program. Generalized information is needed to evaluate public policy issues and fund financial stability. Public policy issues that it might consider include:

- ?? Determining if the activity should continue to be provided by state government
- ?? Evaluating the financial condition of internal service funds to establish confidence in their long-term viability
- ?? Approving the level of and the methodologies for determining the rates that finance the activities of the internal service funded program

More detailed information is needed to empower the legislature to make informed decisions for approving each separate rate that finances the activities.

## **EVALUATION OF THE CURRENT PROCESS**

The concerns of the legislature led to an evaluation and recommendations to improve the process for reviewing and approving internal service fund rate requests. The following examines the current process.

## **INFORMATION PROVIDED WITH THE CURRENT PROCESS**

During the 2001 legislative session, the joint appropriations subcommittees reviewed agency budget requests and provided preliminary recommendations for internal service rates. Appendix A contains an example of the information typically provided to the subcommittees for review and approval of rates for the 2003 biennium.

Typical internal service rate presentations for a program included:

- ?? Descriptions of the program supported by the requested rates
- ?? Descriptions of revenues and expenses of the internal service fund
- ?? High level descriptions of the program rates
- ?? Tables that provide historical and projected revenues, expenses, and retained earnings for each internal service fund
- ?? Decision packages that described adjustments from base year present law activities
- ?? Decision packages that described new proposals that change current service or fund types.

## **SHORTCOMINGS OF THE CURRENT PROCESS**

### **Does the Information Provided Support the Decision?**

A review of the information presented to the joint appropriations subcommittees indicates some successes and shortcomings in how the information relates to the decisions the legislature needed to make.

The focus of the presentation has been on the overall financial profile of the internal service fund regardless of whether one or several separate rates financed the fund. With information such as revenues, expenses, and retained earnings combined for the entire fund, the legislature could make a reasonable assessment of the fund's ability to support the ongoing operations of the program.

However, the following shortcomings were identified:

- ?? The information wasn't broken down to the level of each separate rate. Without adequate details, subcommittee members were frustrated and hampered in their ability to adequately review and approve specific rates, as directed by state law. As such, subcommittees tended to focus on the historical growth of rates instead of the factors that contributed to individual rate growth and the policy implications associated with the factors.

?? Information was not provided at a level needed to fully evaluate the program from a broad policy perspective. For example, in order for the legislature to determine if the activity should continue to be provided by the program, it would need information similar to what a small business would need to provide to a bank in its business plan – market, barrier, and competition analysis.

## Requested Rate Structure

In addition to shortcomings associated with the information presented to the legislature, the review of past rate requests identified that the process for developing and presenting the requests allows for differences between the structure of the rates (the methodology for allocating the rate to customers) reviewed and approved by the legislature and the structure of the rates actually charged to customers. When this occurs, the legislature is reviewing information and making decisions based on a different set of data than would result from actual operation of the program.

One common practice that appears to be growing in popularity is to request that the legislature approve a certain level of working capital<sup>2</sup> reserve in lieu of specific rates. Since working capital is the difference between current assets and liabilities of the program, which are constantly changing, a working capital reserve is not a rate that can be charged to customers. Legislative concurrence for these programs to operate with a certain working capital reserve does not limit the rates that are actually charged to customers and therefore diminishes legislative control of these programs. Additionally, for programs that provide services to federally funded programs, federal principles and standards<sup>3</sup> generally limit working capital reserves to 60 days and require equity in the application of rates.

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<sup>2</sup> Working capital is the mathematical difference between the cash equivalents of current assets and current liabilities. Current assets are cash and other resources that are reasonably expected to be realized in cash within one year. Likewise, current liabilities are obligations that are reasonably expected to be paid from existing current assets or through the creation of current liabilities within one year. Working capital provides some indication of the ability of the fund to meet its current obligations or its operating cash flow needs. The adequacy of the working capital balance to sustain the operating costs of the program provides an indicator of the need for potential adjustments of revenues or service levels so the program can satisfy its mission over the long-term.

<sup>3</sup> Office of Management and Budget circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, states “ Internal service funds are dependent upon a reasonable level of working capital reserve to operate from one billing cycle to the next. Charges by an internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve, in addition to the full recovery of costs, are allowable. A working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes is considered reasonable. A working capital reserve exceeding 60 days may be approved by the cognizant Federal agency in exceptional cases.” Federal guidelines use fiscal year end working capital balances as a measure for compliance verification.

## **RECOMMENDATIONS**

Two broad types of recommendations are provided to address the shortcomings identified in the review of the current process: 1) recommendations to improve the decision process, such as how information is gathered and presented; and 2) recommendations on how to make the decisions once the presentation is made.

### **FOCUS ON THE DECISIONS**

As stated before, budgeting and administrative laws direct the legislature to approve the maximum rates that can be charged to customers to finance the operations of internal service funded programs. The information collected as part of the budget development process and presented to the legislature should support the legislature's task of reviewing and approving each separate rate that finances internal service funds. In addition, the legislature must also review funds for financial stability and programs for public policy issues. Information needed to review funds for financial stability and make rate and policy decisions for the services being provided include:

- ?? Descriptions of the programs providing the services and descriptions of the services provided, including the program's business climate
- ?? Program expenses, revenues, and cash management factors. Expenses and revenues should be provided at a detail that would allow a determination that fees are commensurate with costs for each separate rate, including cost allocation methodologies for equitably allocating indirect costs to the appropriate rates
- ?? Rate allocation methodologies (the methodology for allocating rates equitably to the customers)
- ?? Service volume and rate histories and forecasts
- ?? Service and cost change factors

Specific recommendations for information and minimum contents for presentations to the legislature are described below.

### **RECOMMENDATIONS TO IMPROVE THE DECISION PROCESS**

#### **Starting Point for Rate Requests**

To minimize confusion and add consistency to discussions of internal service rate requests, a starting point should be established and used as basis for comparison when requesting and justifying service rates. Using the actual rates that were charged in the base budget year (the rates in effect at fiscal year end) as the starting point for discussions and decisions will more closely tie the rate approval process to the process used for

making budget decisions. This will eliminate confusion for legislators by providing a more consistent presentation for all program budget decisions.

Recommendation 1 would provide guidance for how requests are made and presented to the legislature, and would provide guidance for how the 2003 legislature may wish to approach the rate approval process. Committee concurrence of this recommendation would signal how the committee recommends the legislature treat rate decisions, which may influence how the program rate requests are developed. If the rate requests are developed to be consistent with the intended decisions, time could be saved during the joint appropriations subcommittee phase of the legislative appropriations process as discussion of any disparities would be eliminated.

***Recommendation 1:***

*Rates should be presented similar to budget funding requests, except the starting point for all rate discussions and decisions should be the actual rates in effect and charged to customers at the end of the base budget year. All changes to these rates should be described and justified by decision packages that must include the rationale for the change, the expense impact, and the rate impact.*

## Information Requirements

The legislature reviews internal service funded programs so it can set the maximum rate for each separate fee and charge the program uses to finance its operation. In addition, the legislature makes policy decisions for the services being provided and reviews the financial stability of the funds. In order to make public policy decisions regarding the program, the legislature needs information about the program's business climate. Descriptions of the following areas would provide this information: 1) the program; 2) its service offerings; 3) its competitive climate; 4) its customers; 5) funding for customer payments; 6) mandates for use of its services by customers; and 7) cash management factors, such as billing and payment cycles. Decisions regarding the fund's financial stability would need income, expense, and equity information accumulated at the fund level.

In order for the legislature to review and approve rate requests, it would need information with details broken down to each separate rate. To accomplish this important activity, the legislature needs information on the following areas: 1) descriptions of services funded by each rate; 2) cost drivers and factors that would impact cost assumptions used in rate development; 3) cost allocation methodologies; 4) service volume; 5) rate allocation methodologies; and 5) service and cost volatility and change factors.

Recommendation 2 provides guidance on what information is needed to conduct a complete and consistent analysis of internal service funded programs, their financial stability, and their rate requests. It is structured as guidance for the Legislative Fiscal

Analyst to, in accordance with 17-7-111, MCA, negotiate with the budget director while preparing for the 2005 biennium budget.

***Recommendation 2:***

*Appendix B contains the minimum information needed to support a consistent and complete legislative analysis of the Executive Budget and to prepare a presentation for legislative review and approval of internal service rates. The Legislative Fiscal Analyst (LFA) shall work with the Governor's budget director to obtain the information contained in Appendix B from internal service funded programs subject to the requirements of Section 17-7-123, MCA. The administering program for the internal service fund should submit information to the Office of Budget and Program Planning (OBPP) and the Legislative Fiscal Division (LFD) in a time frame to be worked out by the budget director and LFA, but no later than September 1, 2002.*

## Presentation Requirements

Changes are recommended to the previous presentation structure and content for internal service fund rate requests. The recommendations are made in order to improve the presentation and to enable the legislature to make more informed decisions. In addition to providing general information about the program, its services, and the fund's overall financial condition, the presentation should provide information for each separate rate at a level of detail that would allow the legislature to approve rates but not become overwhelmed with the details. In order to review and approve rates, the legislature must be presented with the following types of information that portray the services provided for each separate rate: 1) the services; 2) historical and projected volume of the services; 3) costs to provide the service at the volume projected; and 4) factors for any changes from what the previous legislature approved. The presentation should provide adequate information to allow the legislature to make the following determinations:

- ?? Policy determination for the program to continue providing the service
- ?? Adequacy of the program's funding to continue to provide for the operations of the program
- ?? Review and approval of rates to finance the program

Recommendation 3 provides guidance for structuring a presentation of internal service funded programs and their rate requests that would enable the legislature to approve rates, and review program policy issues and fund financial stability. Committee concurrence of this structure and content would provide directions to the Legislative Fiscal Division for analyzing the Executive Budget and drafting the analysis report.



***Recommendation 3:***

*Appendix C contains an outline and description of structure and content requirements for presenting internal service fund information for legislative review and approval. The presentation for internal service funded portions of agency budgets should be presented in the legislative budget analysis in the structure of Appendix C.*

## **RECOMMENDATIONS ON HOW TO IMPROVE THE DECISIONS**

In addition to providing recommendations on how to improve the decision process, additional recommendations are provided regarding how decisions are made for internal service rates.

### **Legislative Verses Charged Rates**

The rates that some programs actually charge their customers are structured differently than those approved by the legislature. For example, a 45-day working capital reserve rate was approved for the 2003 biennium for portions of the Information Services Division when customers are billed via 42 separate rates that are specific to separate services provided by the division. For this fund, the revenue information reviewed by the legislature reflected the actual rates charged to the customers (the 42 rates associated with the 45-day working capital reserve and two other specific rates) and not the rates requested. As such, there wasn't a direct link between the information presented and the rates being requested. In this situation, the legislature did not have adequate information to review the request and make fully informed decisions.

Recommendation 4 provides guidance that would provide consistency between the rates approved by the legislature and the rates actually charged by a program during the biennium. It would provide a direct link between the information the legislature based its rate approval on and the operation of the program under the approved rate. Committee concurrence of this recommendation would signal how the committee recommends the legislature treat rate decisions, which may influence how the program rate requests are developed. If the rate requests are developed to be consistent with the intended decisions, time could be saved during the joint appropriations subcommittee phase of the legislative appropriations process as discussion of any disparities would be eliminated.

***Recommendation 4:***

*Rate methodologies approved by the legislature should be the same as those actually charged to the customers.*

## Working Capital Reserve as a Rate

Some programs continue to request legislative concurrence to operate at or below a certain level of working capital reserve when they actually charge their customers based on specific service factors, such as: per item, per FTE, per transaction, or some other transactional-based measure. Rate flexibility based on operating below a certain working capital balance provides no legislative control of the level of program expenses. Furthermore, since working capital only considers current assets and current liabilities and doesn't include long-term or fixed assets in its calculation, a program could conceivably make large purchases for long-term assets (i.e. equipment), increase rates to finance the purchase, and have no impact on working capital. In fact, any expense increase or decrease that is financed by a corresponding increase or decrease in rates could occur without having any noticeable impact on working capital.

Program managers requesting rates based on maintaining a certain working capital reserve balance have justified their requests with statements such as:

- ?? “The market controls our rates because customers will contract for this service if our rates are too high”
- ?? “If we charge too much the auditors will catch it”
- ?? “We have too many separate items that need separate rates and the legislature doesn't want to look at all of these rates”
- ?? “We're directed to operate like a business and we need flexibility to be able to serve our customers”

The acceptance of a rate that provides no control of the actual rates that can be charged by an internal service funded program is a policy decision facing the legislature. As stated earlier, when the 1995 legislature passed HB 576 it intended to control internal service fund expenses by tying costs to fees and limiting the rate at which fees can be charged. Does the legislature want to have control of internal service funded program expenses, albeit indirect control via limitations on the revenue rate, or does it want to relinquish this control to market factors, auditors, and program managers while still appropriating the budgets for the customers who pay the rates? Continuing to approve rates based on maintaining a specified level of working capital reserve effectively negates, for some programs, that portion of Section 17-7-123(6)(b), MCA, which states, “Fees and charges in a biennium may not exceed the level approved by the legislature in the general appropriations act effective for that biennium.”

Recommendation 5 provides guidance for dealing with requests for rates that are based on maintaining a certain level of working capital reserve. Its acceptance would strengthen the legislature's control of internal service funded program expenses in a manner similar to how appropriations control budgeted fund expenditures. Committee concurrence of this recommendation would signal how the committee recommends the

legislature treat rate decisions, which may influence how the program rate requests are developed. If the rate requests are developed to be consistent with the intended decisions, time could be saved during the joint appropriations subcommittee phase of the legislative appropriations process, as discussion of any disparities would be eliminated.

Likewise, if the committee doesn't concur with this recommendation, it sends a signal to staff that the legislature is willing to consider rates based on maintaining a certain working capital reserve. This would save staff time developing issues that may arise if programs request such rates.

***Recommendation 5:***

*Rates defined as maintaining a working capital reserve should be expressly discouraged.*

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# APPENDIX A

Example of Previous Presentation to the Legislature –  
Proprietary Funded Portions of Programs

## PROPRIETARY RATES

### Publications and Graphics Account (A/E 06530)

#### Program Description

The Publications and Graphics Bureau prints; duplicates; provides photocopy pool copiers; provides typography; provides all aspects of graphic design and production, including layout and design, graphic and illustrative art, photo-reprographics, binding, and quick copy; and contracts certain printing functions to private printing vendors.

#### Proprietary Revenues and Expenditures

The program anticipates revenues of \$5.7 million in fiscal 2002 and \$6.1 million in fiscal 2003. These amounts are increases of approximately 8 percent and 14 percent, respectively, over base year revenue. The program anticipates expenses of \$5.8 million in fiscal 2002 and \$6.2 million in fiscal 2003. These amounts are increases of approximately 8 percent and 16 percent, respectively, over base year expenses. The Report on Internal Service & Enterprise Funds, 2003 Biennium for fund number 06530 shows historical and projected revenues, expenses, fund equity, and retained earnings for the publications and graphics internal service fund.

Report on Internal Service & Enterprise Funds, 2003 Biennium								
	Fund Number 06530	Fund Name Publications & Graphics	Agency Number 6101	Agency Name Department of Administration	Program Name			
Fund Balance Information								
	<b>FY96</b>	<b>FY97</b>	<b>FY98</b>	<b>FY99</b>	<b>FY00</b>	<b>Estimated FY01</b>	<b>Estimated FY02</b>	<b>Estimated FY03</b>
Beginning Retained Earnings	1,323,788	1,259,002	1,253,238	1,104,978	1,135,694	1,047,846	772,919	697,524
Increases								
Fee Revenue	6,392,741	6,454,867	6,212,956	5,464,557	5,312,666	6,498,100	5,736,992	6,074,862
Investment Earnings	-	-	-	594	-	-	-	-
Transfers In	-	-	-	-	-	-	-	-
Miscellaneous, operating	-	-	50	1,267	1,569	-	-	-
Miscellaneous, other	-	13,148	-	-	-	-	-	-
<b>Total Increases</b>	<b>6,392,741</b>	<b>6,468,015</b>	<b>6,213,006</b>	<b>5,466,418</b>	<b>5,314,235</b>	<b>6,498,100</b>	<b>5,736,992</b>	<b>6,074,862</b>
(Decreases)								
Personal Services	754,187	862,267	774,991	862,663	802,792	958,171	871,090	969,086
Operations	5,698,851	5,611,512	5,536,848	4,570,634	4,516,113	5,632,911	4,660,643	4,899,496
Transfers Out	-	-	-	-	-	181,945	280,654	310,154
Miscellaneous, operating	-	-	-	-	15,573	-	-	-
Miscellaneous, other	4,489	-	14,160	8,990	7,192	-	-	-
<b>Total Decreases</b>	<b>6,457,527</b>	<b>6,473,779</b>	<b>6,325,999</b>	<b>5,442,287</b>	<b>5,341,670</b>	<b>6,773,027</b>	<b>5,812,387</b>	<b>6,178,736</b>
Adjustments to Beginning Retained Earnings	-	-	(35,267)	6,585	(60,413)	-	-	-
<b>Ending Retained Earnings</b>	<b>1,259,002</b>	<b>1,253,238</b>	<b>1,104,978</b>	<b>1,135,694</b>	<b>1,047,846</b>	<b>772,919</b>	<b>697,524</b>	<b>593,650</b>
Total Contributed Capital	-	-	-	-	-	-	-	-
<b>Total Fund Equity</b>	<b>1,259,002</b>	<b>1,253,238</b>	<b>1,104,978</b>	<b>1,135,694</b>	<b>1,047,846</b>	<b>772,919</b>	<b>697,524</b>	<b>593,650</b>
Unreserved Fund Balance								
60 Days of Expenses (i.e. total of personnel services, operations, and miscellaneous operating divided by 6)	1,075,506	1,078,963	1,051,973	905,550	889,080	1,098,514	921,956	978,097
<b>Fee/Rate Information for Legislative Action:</b>								
Requested Rates for Internal Service Funds	xxxx	xxxx	The program must maintain a break-even approach in their operations, and have a large number of individual rates for the various products or services provided. Therefore, previous legislatures defined "rates and fees" for the program to mean a specific working capital reserve balance. The P & G Bureau requests a 60-day working capital reserve.					

## Proprietary Rates

The program requests that the legislature allow it to charge fees for its services that would allow it to maintain a 60-day working capital reserve. The program requests that the legislature approve a rate for operation of the Publications and Graphics Bureau based on maintaining no more than a 60-day working capital reserve.

### LFD ISSUE

The program has requested 60-day working capital rate, justifying the request with the rationale that a 60-day working capital rate provides flexibility to adjust rates due to demand for services. The program has stated that the flexibility gained from a 60-day working capital rate would allow the program to lower or increase the rates charged to agencies to respond to business volume the program experiences without the need to inflate their rates to meet unanticipated increases in the cost of goods needed to provide the service.

The issues, "Legislative Approval of Fees and Charges," contained in the agency section of this report for the department shows that financial laws for fees and charges as long as they are below the maximum levels approved by the legislature and they are commensurate with costs. As such, the legislature may wish to request that the program provide a schedule of specific fees and charges for legislative approval as the maximum rates for the 2003 biennium.

DP 1 – Programmer: P&G – This request would fund the addition of 0.34 FTE grade 15, programmer/analyst and associated operating expenses to provide dedicated programming and computer support. The executive is requesting funding at the market salary level and has identified the difficulty to recruit and retain information technology personnel as the basis for the request. The executive has requested funding for 0.67 FTE, but 0.33 FTE of this request is being requested in the HB 2 funded portion of this program.

Rate Impact: This request would provide no material impact on the fees and charges proposed by the program.

DP 6 - P&G Present Law Adjustment - The executive requests funding for overtime and increases in operating expenses and equipment. Overtime would provide annual overtime below the base level to cover rush printing jobs and fiscal-year-end printing and also would provide an additional \$12,200 in fiscal 2003 to support the 2003 legislative session.

Increases in operating expenses would fund: 1) increases in the cost of printing supplies; 2) the cost of maintenance, paper, and other printing supplies during the 2003 legislative session; 3) inflationary increases in the cost of goods purchased for resale; and 4) higher per-copy photocopy term contract costs in fiscal 2003. Increases are expected for the per-copy photocopier term contract as the current contract is rebid. The primary factor behind the photocopier per-copy contract increase is that digital copiers would be provided instead of the analog photocopiers that are currently being used.

Increases in equipment would fund an additional \$50,000 per year to cover the installment purchase of a high speed electronic processing duplicator and \$120,500 in fiscal 2002 and \$150,000 in fiscal 2003 to replace worn out, fully-depreciated existing duplicating equipment.

Rate Impact: This request would provide no material impact on the fees and charges proposed by the program.

# APPENDIX B

## Recommended Information Requirements for Analysis of Internal Service Fund Rate Requests



# **RECOMMENDED INFORMATION REQUIREMENTS FOR ANALYSIS OF INTERNAL SERVICE FUND RATE REQUESTS**

## **DATA RANGE AND DATA RECIPIENTS**

Information for evaluating internal service rates should be provided for the six fiscal years (**data range**) that include: 1) the previous biennium; 2) the current biennium; and 3) the budget (rate) request biennium. The administering program should provide the internal service fund rate information to both the Office of Budget and Program Planning (OBPP) and the Legislative Fiscal Division (LFD).

## **RELATIONSHIPS – DECISION AND INFORMATION NEEDS**

The legislature makes three types of decisions when dealing with internal service funds: 1) public policy; 2) fund financial stability; and 3) rate setting. The information needs for each of these decision types are different.

For public policy decisions, the legislature needs general information about the program, such as: 1) services the program provides; 2) to whom the program provides the services; 3) the market for the services; 4) alternatives available for satisfying the service need; and 5) barriers to using the alternative service options.

For fund financial stability, the legislature needs financial information summarized at the fund level, such as: 1) revenues and revenue trends; 2) expenses and expense trends; 3) cash reserve requirements; 4) fund equity and equity trends; and 5) balance sheet profiles (makeup of assets and liabilities that influence the fund equity).

For rate setting, the legislature needs revenue, expense, and service demand information with details broken down to each separate fund.

## **INFORMATION REQUIREMENTS**

### **Program and Services**

For each internal service fund, the legislature must address general policy issues. Therefore, information provided for *each fund* must include:

- ?? A general description of the internal service funded program, including services provided in exchange for a fee or charge, and statutory authority for the program to provide the service

- ?? A discussion of the availability of alternate sources (alternate funding and/or alternate provider) for the service provided by the program
- ?? A description of the customers served by the program (customer base), and any customers for whom use of the program is mandated (in law, rule, or written policy) regardless of alternate source availability (please specify the authority for the mandate)
- ?? For the previous and current biennia, a description of any program reorganization or major changes to services provided or customer base

## REVENUES

Revenues are used to address fund stability and rate-setting issues. Because revenues are specific to each rate, information must be provided for *each rate* charged by the program, to include:

- ?? The specific services provided in exchange for customer payments and the SABHRS accounts used by the customers to record the expenditures for payment of the fees and charges (6xxxx)
- ?? The customer base for the specific service funded by the fee or charge if different than the customer base for the overall fund
- ?? The historical and projected trends associated with volume of services provided, with justifications provided for trend changes
- ?? The base year funding, by fund type, for customer payments made to the program (how the payments for the service were funded by the customers)

## EXPENSES

Expenses are used to address fund stability and rate-setting issues. In describing all expenses incurred by a program, agencies must identify and explain:

- ?? The major cost drivers of *each separate rate*, including the assumptions used to anticipate future expenses related to the cost drivers, and any factors contributing to uncertainty in forecasting these expenses
- ?? Non-typical and one-time expenses included in the data range, as defined above
- ?? Variations in expense patterns
- ?? The number of FTE funded by the legislature for the base year within the program

## WORKING CAPITAL, FUND EQUITY, AND COST MANAGEMENT

The following information is used to address fund stability and rate-setting issues, and is provided with details summarized at the *fund* level:

- ?? A description of the program's approach for maintaining fees commensurate with costs, including any requirements the program has to reserve a fund balance
- ?? An explanation and justification of the amount of working capital needed to maintain ongoing operations, including the influence of revenue and expense cycles, if applicable. If working capital is considered in the determination of rates, justification must be provided
- ?? A description of the balance sheet accounts (assets and liabilities) that contribute most significantly to any fund equity balance, including the amount of fund equity attributed to working capital. For example, the service of the program may be that it rents equipment. Therefore, a large percentage of the assets that contribute to the fund equity are equipment that is rented to customers for a fee

## RATE EXPLANATION

Internal service funded programs should justify all requested rates as follows and information *must be provided for each separate rate (fee or charge), unless noted otherwise*:

- ?? Explain and justify the methodology used to allocate each unit of service to customers, such as per occurrence, percentage of base year personal services, fixed rate, or maximum amount of charges that can be recovered from customers, and why that methodology is the most appropriate
- ?? Explain and justify any instance where the methodology used to develop the requested rate is different than the methodology used to develop the rate actually billed to the customers
- ?? Explain how the requested rates were determined
- ?? For programs with more than one rate providing revenues to a single internal service fund, explain the allocation methodology for distributing indirect costs to separate rates (*If the methodology is the same for all rates only one explanation. Provide a separate explanation only if the allocation methodology is different than the general allocation methodology.*)

In order to better document and evaluate requests for internal service rates, the administering program should provide supplemental schedules that provide the following items for the data range and *for each separate rate*:

- ?? Actual rate(s) charged or anticipated to be charged to the customers
- ?? Legislatively approved rate(s), *if different than rates charged to customers*
- ?? Actual and forecasted volume of services (forecasted volumes should be the volumes used to develop the rate requests)
- ?? Allocation of indirect costs broken out into first level SABHRS expense accounts
- ?? Direct costs broken out into first level SABHRS expense accounts and designated with the percentage of direct costs that are fixed or variable costs

## **ADJUSTMENTS TO THE BASE RATE**

When a rate is requested that is different than the actual rate charged to customers at the end of the base year, the difference shall be justified in decision packages that describe the rationale for the rate adjustment (new customer group added, different key cost factor, new requirements, change in volume that move costs to a new break point, etc.) and the amount of rate adjustment attributable to the decision package.

# APPENDIX C

Recommended Presentation to the Legislature -  
Internal Service Funded Portions of Programs

## PROPRIETARY RATES

Internal Service Fund Name (fund number)

**Program and Service Descriptions** (This would require a change to MBARS program that generates the legislative budget analysis book)

Here the internal service funded program and the service(s) provided by the program would be described. The description would include:

- ?? The statutory authority for the program to provide the service(s)
- ?? The customer groups served by the program
- ?? The availability and restrictions for obtaining services from alternate sources
- ?? Recent changes in the program organization, services, and customer base.

**Proprietary Revenues, and Expenses, and Fund Equity** (This would require a change to MBARS program that generates the legislative budget analysis book)

Here revenues, expenses, and the resulting fund equity profiles would be described. For revenues, descriptions would include:

- ?? Each service provided in exchange for a separate fee
- ?? The customer base for each separate service, if more than one fee is charged and there are difference in customer groups for each service
- ?? Historical and assumed future service volumes
- ?? Funding of base year customer payments, by fund type

For program expenses, personal services and other major cost drivers would be described, as would other factors that could impact the assumptions used to develop rates. Non-typical or one-time expenses would be explained when they occur in data provided within the presentation. When specific costs can be directly attributed to a specific rate, the relationship would be further explained, as would the methodology used for allocating indirect costs to separate rates.

For fund equity balances, the relationship between working capital and long-term equity components as equipment, inventories, and land holdings would be described. Working capital issues that would be discussed include: 1) disbursement and payment receipt cycles that would dictate maintaining a certain level of cash to meet operating needs; and 2) influences of working capital balances on the development of rates. A discussion

would also be provided to explain how long-term equity components factor into the program's ability to provide services to its customers.

**Proprietary Rates Explanation** *(This would require a change to MBARS program that generates the legislative budget analysis book)*

Here each separate rate charged by the program would be discussed.

Report on Internal Service Funds, 2005 Biennium						
Fund Name	Fund Number	Agency Name		Program Name		
Internal Service	065xx	Department Name		Program Name		
	FY00	FY01	FY02	Estimated FY03	Estimated FY04	Estimated FY05
<b>Operating revenues:</b>						
Fee revenue						
Revenue from Fee A	165,000	169,950	175,049	180,300	185,709	191,280
Revenue from Fee B	280,000	288,400	297,052	305,964	315,142	324,597
Revenue from Fee C	390,000	401,700	413,751	426,164	438,948	452,117
Net fee revenue	835,000	860,050	885,852	912,427	939,800	967,994
Investment earnings	-	-	-	-	-	-
Securities lending income	-	-	-	-	-	-
Premiums	-	-	-	-	-	-
Other operating revenues	-	-	-	-	-	-
Total operating revenues	835,000	860,050	885,852	912,427	939,800	967,994
Intrafund revenues	-	-	-	-	-	-
Net operating revenues	835,000	860,050	885,852	912,427	939,800	967,994
<b>Operating expenses:</b>						
Personal services	292,000	300,760	309,783	319,076	328,649	338,508
Operating expenses	534,000	550,020	566,521	583,516	601,022	619,052
Miscellaneous, operating	-	-	-	-	-	-
Miscellaneous, other	-	-	-	-	-	-
Total operating expenses	826,000	850,780	876,303	902,593	929,670	957,560
Intrafund expenses	-	-	-	-	-	-
Net operating expenses	826,000	850,780	876,303	902,593	929,670	957,560
Operating income (loss)	9,000	9,270	9,548	9,835	10,130	10,433
<b>Nonoperating revenues (expenses):</b>						
Gain (loss) on sale of fixed assets	-	-	-	-	-	-
Federal indirect cost recoveries	-	-	-	-	-	-
Net nonoperating revenues (expenses)	-	-	-	-	-	-
Income (loss) before contributions and transfers	9,000	9,270	9,548	9,835	10,130	10,433
Operating transfers in	-	-	-	-	-	-
Operating transfers out	-	-	-	-	-	-
Contributed capital	-	-	-	-	-	-
Retained earnings July 1	250,000	259,000	268,270	277,818	287,653	297,782
Net income (loss)	9,000	9,270	9,548	9,835	10,130	10,433
Retained earnings June 30	259,000	268,270	277,818	287,653	297,782	308,216
60 Days of Expenses (i.e. total of personnel services, operations, and miscellaneous operating divided by 6)	137,667	141,797	146,051	150,432	154,945	159,593
<b>Historical Fee/Rate Information (Actual Rates Charged to Customers):</b>				<b>Requested Rates</b>		
Fee A (per occurrence)	0.206	0.212	0.219	0.225	0.232	0.239
Fee B (per base year FTE)	0.350	0.361	0.371	0.382	0.394	0.406
Fee C (per unit)	0.488	0.502	0.517	0.533	0.549	0.565